From: jerimiah.booream@ubs.com
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Subject: UBS: NRG: Moving to the Next Stage: Upgrading to Buy ($20 PT)
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NRG Energy Inc.

Moving to the Next Stage: Upgrading to Buy

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Upgrading to Buy; Magnitude of cost cuts remains central to the story

We are upgrading NRG to Buy as the GenOn settlement and the latest PJM auction add clarity to the story while the cost cutting thesis remains intact and the major near term catalyst for the stock. While the deadline for the review is set for Aug 14, we expect more details to transpire sooner and could well see mgmt. update 2017 guidance in the coming weeks given the added clarity provided by the GenOn settlement. We continue to assume $140 Mn of cost cuts related to unallocated expenses as well as the complete offset of the GenOn dis-synergies (~$100 Mn) in our base case valuation and see further savings potential within the retail and renewable segments.

GenOn settlement constructive for NRG as move beyond legacy portfolio

We see the proposed GenOn settlement as positive, as the ~$150 Mn net cash contribution (plus the assumption of the ~$120 Mn underfunded pension plan) is lower than many investors feared given the tangible threats of substantial litigation, notably related to the Shared Services

Agreement and previous asset transfers. Under the settlement, NRG would be fully released from any obligations and the noteholders would drop all litigation with NRG. With the GenOn RSA now garnering more than 90% support among both GAG and GEI noteholders, we expect the proposed plan to be implemented within the next 4-6 months (see our full review of the RSA here).

PJM Auction now behind; adds further clarity

The recent PJM auction removes yet another uncertainty for the stock. Despite a headline RTO number down ~24% YoY, NRG ex-GenOn cleared most if not all of its assets, and the negative impact on revenue was mitigated by the exposure to higher-priced regions. Further, with the company splitting from GenOn, NRG is decreasing its exposure to lower-priced regions such as PEPCO and MAAC and becoming more of a EMAAC play (~84% of pro forma PJM capacity) which was able to retain its premium pricing in the last auction at ~$188/MW-day (see our related notes here and here).

Valuation: Upgrade to Buy, Increase PT to $20/Sh; awaiting guidance update

We are upgrading NRG to Buy and increasing our PT by $1 to $20/Sh as we mark-to-market our power and gas price assumptions and include the impact of the GenOn settlement (cash contribution and pension assumption). Our valuation remains based on a 2020E SOTP.

Buy (Price target US$20.00)

NRG Energy Inc.

UBS Research THESIS MAP a guide to our thinking and what's where in this report

PIVOTAL QUESTIONS Q: What is the cost savings opportunity?

NRG's relative O&M and SG&A expenses seem larger than peers at first sight. While we believe this is partly explained by the differentiated business model (large retail operation, large renewable portfolio), we believe there is room to reduce these expenses. Specifically, mgmt. has indicated $140 Mn of unallocated expenses will essentially go away in the 2018 timeframe. Additionally, mgmt. is confident it can offset a substantial portion of the synergy losses associated with the GenOn separation, which we estimate at ~$100 Mn. While we include these two items in our base valuation as we see these as the most tangible cuts so far, we could see further savings potential on the retail and renewable front. We expect further clarity at the formal BRC deadline on Aug 14, if not earlier.

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Q: Is the GenOn settlement a good outcome for NRG?

We believe the $150 Mn net cash contribution and the assumption of ~$120 Mn of pension liability as part of the settlement with noteholders is a positive for NRG as that amount is lower than many investors feared given the tangible threats of substantial litigation, notably related to the Shared Services Agreement and previous asset transfers. The main question remains the extent to which the company can cope with losing the Shared Services Agreement; the company remains confident it can offset a significant portion of the loss.

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UBS VIEW

With the GenOn overhang likely to be resolved in the near future given the 90+% RSA support, and with the latest PJM auction past us, we believe the story has become substantially clearer and now comes down to the findings of the Business Review Committee (BRC). We believe the stock has come down substantially from its highs in mid-April (see chart below) as mgmt. had been a bit more cautious on the magnitude of potential cost savings than many had anticipated on their recent 1Q call. While the shares have partially recovered since on the back of the broader power sector, we see incremental upside to NRG equity valuations given the more modest expectations baked into the shares.

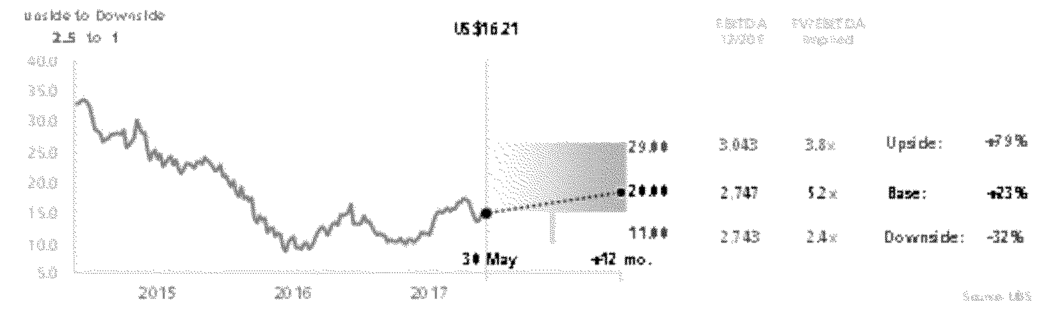
EVIDENCE

Mgmt. recently provided its cost structure and comparisons, presenting the company favorably vs. peers on an O&M plus SG&A plus maintenance capex per kW basis. We see benchmarking as skewing constructively on cost cuts. We assume ~$240 Mn cost savings in our base valuation.

WHAT'S PRICED IN?

The market is giving NRG little credit to its ability to achieve significant cost savings. At current prices, the market implies ~$100 Mn of cost cuts vs. the ~$240 Mn estimate in our valuation.

UPSIDE / DOWNSIDE SPECTRUM



Value drivers 2020E EV/EBITDA Multiple | Cost Savings ($Mn) | NYLD Value per NRG Shares

$11

$29 upside	8.7x	$380	$5.08
$20 base	7.3x	$240	$4.81
downside	6.1x	$100	$4.54

Source: UBS

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COMPANY DESCRIPTION NRG Energy, Inc. (NRG) operates one of the largest independent power generation portfolios and retail electricity businesses in the US. NRG controls over 46GW of power generation...

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NRG Energy Inc. UBS Research

COMMENTARY

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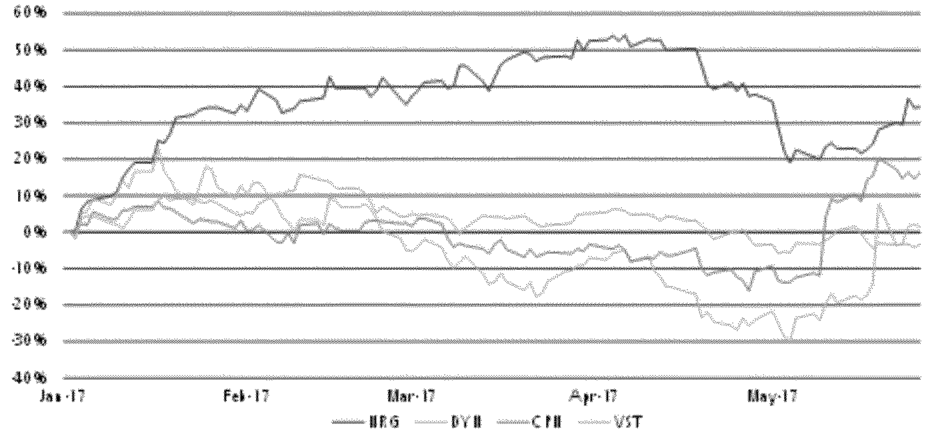
What Do We Think of the Shares?

With the GenOn overhang poised to be resolved in the near future given the 90+% RSA support, and with the latest PJM auction past us, we believe the story has become substantially clearer and now comes down to the findings of the Business Review Committee (BRC), more specifically how much cost savings can be realized and what is the strategic direction for the Renewable business and ownership of NYLD. While the official deadline for the BRC remains Aug 14, we'd expect more tangible details to likely emerge within a shorter timeframe. Specifically, we look for mgmt. to formally update guidance and provide an updated view of their strategy and costs outlook ex-GenOn in the near term.

We believe the stock has come down substantially from its highs in mid-April (see chart below) as mgmt. had been a bit more cautious on the magnitude of potential cost savings than many had anticipated on their recent 1Q call. While the shares have partially recovered since on the back of the broader power sector, we see incremental upside to NRG equity valuations given the more modest expectations baked into the shares. Indeed, current levels imply cost savings of only ~$100 Mn vs. the ~$240 Mn estimate in our valuation (the previously announced $140 Mn of unallocated expenses, plus the offset of the GenOn dis-synergies, which mgmt. is confident it can achieve), and a far cry from the $1 Bn estimate some investors have been contemplating.

Furthermore, we perceive an upside skew on NYLD. While mgmt. has expressed its commitment to the YieldCo and its renewable business thus far, we see pressures to divest the portfolio as part of the cost evaluation process, as a divestment would notably allow the company to cut on development expenses ($90 Mn in 2016). The question remains whether the company would be able to sell NYLD at a premium to current levels; as NRG uses the YieldCo as a growth platform, we doubt the company would part with NYLD unless a substantial premium is realized. We further note the recent consolidation in the space (TERP being acquired by Brookfield, FSLR selling its interest in CAFD, and ABG in the process of selling its ~42% stake in ABY) is also constructive.

Figure 1: YTD Stock Performance



Source: FactSet

What are the key issues that have been resolved?

We note the following developments in recent months that augur well for shares aside for the forthcoming guidance updates.

- **VST's retail value readthrough:** We see the healthy valuation embedded in shares reflects well upon confidence in retail valuations and presents a clear valuation readthrough back to NRG. We expect valuation methodologies and implied EV/EBITDA to converge over time. We note our Sell rating on VST is embedding the same unlderying valuation multiples that our NRG upgrade below is embedded upon including potential cost synergies from both.

- **PJM de-risking:** With NRG's stand-alone prospects now largely oriented in ComEd, we see a certain degree of resiliency in pricing. Overall, we see an ability now to eactually *expand* pback into PJM should the company so choose, enabling yet another strategic angle in the future. Any such move would likely be accompanised by corresponding corporate synergies and re-enabling of corporate synergies

- **Private value bid for IPPs?** We note that the bid for Calpine has reinvigorated a willingness to value IPP assets of all flavors; we see NRG as a potential beneficiary of this lower discount rate.

- **Focused on cost reductions—and market improvement:** We emphasize that both NRG and peers will continue to look at both O&M and SG&A, both improving their EBITDA projections, likely in the near-term with updated pro-forma GenOn update (potentially in the next several days) but also in likely tightening up the ERCOT market. We note sparks have begun to shift back upwards as reflected in our updated estimates.

- **GenOn resolution:** We see shares as de-risked around the resolution here with both a figure well within Street expectations as well as seeming clean move away without protracted litigation around peripheral issues (such as previous asset transfers to NYLD, etc).

The Question on Cost Reductions

We emphasize cost reductions remain a clear focus for mgmt. into any updated guidance without GenOn as well as into the 2Q BRC update. We caution that updates could well involve both costs to achieve as well as an extended timeline to achieve ultimate savings. We also emphasize the importance of noting EBITDA and capital improvements in prospects. Further, we see asset retirements and divestments as critical to this overall repositioning, specifically around its Texas wholesale portfolio which appears to generate material negative FCF on an open basis. While we may not get the full cost updates in coming weeks with the pro-forma GenOn outlook this should provide an early indication of where these factors are headed. While mgmt. cautioned with 1Q on how it wanted to position its total cost cuts, we see our $20 PT as predicated on simply the offsetting of GenOn costs as well as the $140 Mn in Corporate SG&A, well below the contemplated cuts expected across the Street.

Updated Valuation: Increase PT to $20/Sh

We are upgrading to Buy and increasing our price target by $1 to $20/Sh. We continue to include **$240 Mn of cost savings associated with the BRC**, including the <u>$140 Mn of Corporate SG&A cuts as well as assuming the loss of GenOn will not result in any corresponding dis-synergies, which represents a ~$100 Mn of improvement</u> in cost structure to re-assign and reduce the allocated portion of the cost savings. Our valuation remains based on a 2020E SOTP. The $1/Sh price target increase is explained by the following factors:

- Including the ~$261 Mn cash contribution as well as ~$120 Mn underfunded GenOn pension plan liability NRG will assume as part of the GenOn settlement.

- Marking-to-market our power and gas price assumptions to reflect the latest forward curves (resulting in 2020E EBITDA increase of ~$120 Mn all else equal) and NYLD stock price increase from $17.50 to $17.78.

- Compared to our previous iteration, we are now formally excluding all GenOn-related items, including $112 Mn of operating leases payments, $89 Mn of 2019E EBITDA, the $2,525 Mn of non-recourse debt, the $929 Mn PV of operating leases, as well as $1,034 Mn of cash. Note that this <u>does not affect our valuation</u> as we were already adding back the negative GenOn equity value (~$3.50/Sh).

- We also combined our Northeast and EME lines (excluding the Trading segment, which we continue to capitalize at a lower multiple) under the new Northeast/Midwest line, with no effect on the overall valuation.

Figure 2: Updated SOTP Valuation

NRG Energy Valuation	2020E EBITDA	EV/EBITDA Multiple				Enterprise Value (	
		Low	Prem/ Discount	Base	High	Low	Base
Base IPP Multiple =				*8.0x*			
Texas	12	7.0x	*0.0x*	8.0x	9.0x	86	98
South Central	41	7.0x	*0.0x*	8.0x	9.0x	290	331
Northeast/Midwest	278	7.0x	*0.0x*	8.0x	9.0x	1,949	2,227
EMMT (Trading)	32	5.0x	*-2.0x*	6.0x	7.0x	158	189
West (All-Inclusive)	68	5.0x	*-2.0x*	6.0x	7.0x	341	409
Renew (Ex-Ivanpah)	230	10.0x	*3.0x*	11.0x	12.0x	2,297	2,527
Retail Businesses (Reliant, GM, E+, D)	704	5.0x	*-2.0x*	6.0x	7.0x	3,522	4,227
Other, Corporate, and Unallocated							
Synergies	506	6.0x	*-1.0x*	7.0x	8.0x	3,033	3,539
Cost Savings	140		*-1.0x*	7.0x		-	980
Total / Implied	**2,011**	**5.8x**	***-0.8x***	**7.2x**	**8.6x**	**11,675**	**14,527**
Net Debt and Other: 12/31/16							
NRG Recourse Debt						(7,795)	(7,795)
EME PV Operating Leases						(88)	(88)
GenOn Settlement Cash Contribution						(261)	(261)
GenOn Underfunded Pension Plan						(120)	(120)
Other Conventional Debt (Non-Recourse)						(238)	(238)
Solar Non-Recourse Debt (Ex. Ivanpah)						(1,736)	(1,736)
Cash						939	939
NPV of Equity using Hedged EBITDA Methodology						**2,376**	**5,228**
Open Analysis							
Power Hedges	(92)	6.2x		7.2x	8.2x	(572)	(664)
Total						**(572)**	**(664)**
add NPV of Power Hedges							357
NPV of Equity using Open EBITDA Methodology						**2,160**	**4,920**
NYLD Class A & C Average Share Price						**16.78**	**17.78**
NYLD Equity Value						1,434	1,520
$/share for NRG Energy (85Mn Shares Owned (B & D)]						**4.54**	**4.81**
Estimated 2020 Shares Outstanding						316	316
Equity value per share						**$11.00**	**$20.00**

Source: Company Filings, FactSet, UBSe

Updated EBITDA Estimates

We include below our updated EBITDA estimates, which we marked to market to reflect the latest power and gas forward curves. We are now formally excluding GenOn from our estimates starting in 2018. Additionally, we continue to expect 2017E EBITDA towards the low end of the range at ~$2,740 Mn, plus an estimated $70 Mn in cost savings.

Figure 3: Updated EBITDA Estimates

NRG Energy EBITDA ($Mn)	2015A	2016A	2017E	2018E	2019E	2020E
Texas	470	204	86	30	8	12
South Central	118	136	123	36	45	41
Northeast/Midwest	1,034	711	239	326	336	310
West	102	219	120	71	68	68
NYLD Eligible	171	187	139	197	241	260
NYLD	720	899	920	797	796	796
Guidance	705	*885*	*920*			
Retail Businesses	739	811	705	700	702	704
Guidance	700-750	*725-775*	*700-780*			
Less Hedge Monetization			(98)			
Corporate, Other, and Unallocated Synergies	(37)	(77)	506	506	506	506
Cost Savings			70	140	140	140
NRG Adj. EBITDA (UBSe)	**3,317**	**3,257**	**2,809**	**2,802**	**2,841**	**2,838**
Prior EBITDA Est. (UBSe)	*3,376*	*3,257*	*2,782*	*2,975*	*2,867*	*2,747*
Consensus EBITDA Est. (05/30/17)			2,728	2,876	2,836	2,705
GenOn EBITDA Est. (Excl.)			144	228	89	(20)

Source: Company Filings, FactSet, UBSe

NRG Energy Inc. UBS Research

PIVOTAL QUESTIONS return Ó

Q: What is the cost savings opportunity?

UBS VIEW

NRG's relative O&M and SG&A expenses seem larger than peers at first sight. While we believe this is partly explained by the differentiated business model (large retail operation, large renewable portfolio), we believe there is room to reduce these expenses. Specifically, mgmt. has indicated $140 Mn of unallocated expenses will essentially go away in the 2018 timeframe. Additionally, mgmt. is confident it can offset a substantial portion of the synergy losses associated with the GenOn separation, which we estimate at ~$100 Mn. While we include these two items in our base valuation as we see these as the most tangible cuts so far, we could see further savings potential on the retail and renewable front. We expect further clarity at the formal BRC deadline on Aug 14, if not earlier.

EVIDENCE

The $140 Mn of unallocated expenses classified as Corporate Overhead are for the most part associated with resi solar, a business NRG is winding down, thus giving us confidence these costs will be substantially reduced or eliminated by 2018.

WHAT'S PRICED IN?

The market is giving NRG little credit to its ability to achieve significant cost savings. At current prices, the market implies ~$100 Mn of cost cuts vs. the ~$240 Mn estimate in our valuation.

Cost analysis by segment

We include two main sources of cost savings in our valuation:

- The $140 Mn of NRG Corporate expenses are unallocated expenses, which are largely associated with the Resi Solar business NRG is winding down. Other items include the stadium naming rights which expire in 2032. We stress <u>these are the most tangible cost cuts so far as mgmt. assures these expenses will essentially go away in the 2018 timeframe. We assume the full $140 Mn of savings in our base valuation</u>.

- The $208 Mn of GenOn SG&A cost is mainly composed of the ~$193 Mn shared services payment, and we estimate ~$100 Mn of that is NRG cost allocated to GenOn. With the company splitting from GenOn, <u>mgmt. remains confident it can offset a substantial part of the synergy loss through cost cutting and redundancy elimination measures. We assume $100 Mn of savings in our base valuation</u>.

We further highlight the following points:

- We contrast <u>Renew's cost relative to NYLD's</u>, particularly on an <u>SG&A/kW basis which is almost tenfold for Renew at ~$29/kW vs. $3.4/kW for NYLD</u>. We suspect the discrepancy is likely due to the at-cost services agreement between NRG and the yieldco, as well as the more expensive Ivanpah. Further development opportunities remain also exclusively within the purview of NRG the parent sponsor; while the bulk of development costs are reflected in a separate 'development line item, there are still costs allocated to Renew for this purchase. While we don't exclude some cost re-allocation in the future, we doubt it would be implemented given the valuation arbitrage at NYLD. Regardless, the size of Renew ($60 Mn SG&A for ~$200 Mn total cost) somewhat limits the scale of any potential savings. In any event, we emphasize the main question remains how NYLD fits into NRG's overall strategy; we note mgmt. continually stresses the importance of a strong and growing renewable pipeline, with NYLD as its centerpiece as a platform to monetize assets and capitalize on the fundamentals of the industry.

- How much savings can be achieved at the Retail segment remains the main unknown ($800+ Mn of total costs in 2016, and ~half of the company's consolidated SG&A). A future question as part of NRG's cost mgmt. reductions remains whether costs specific to the retail effort to focus more narrowly on just the incumbent portfolio rather than retaining low margin customers via costly customer acquisition and retention efforts merits the effort. A further question is to what extent the expensive marketing arrangement in place maintains the brand recognition necessary to ensure legacy customers remain. We see this as a secondary angle in the cost reduction exercise.

Figure 4: Cost Analysis

	Capacity (MW)	Generation (TWh, 2016)	2016A Costs ($Mn) Total O&M	SG&A	Total	$/kW O&M	SG&A	Total	$/MWh O&M	SG&A
Consolidated NRG	**49,850**	**105.9**	**2,566**	**1,101**	***3,667***	**$43.4**	**$22.1**	***$73.6***	**$20.4**	**$10.4**
NRG Corporate	114	0.0	-16	156	*140*					
Retail	0	0.0	341	497	*838*					
Renew	2,053	3.9	141	60	*201*	$68.7	$29.2	*$97.9*	$36.3	$15.5
NYLD	4,692	11.2	239	16	*255*	$50.9	$3.4	*$54.3*	$21.4	$1.4
GenOn	16,423	26.0	639	208	*847*	$38.9	$12.7	*$51.6*	$24.6	$8.0
Core Generation	**26,682**	**64.9**	**1,222**	**164**	***1,386***	**$45.8**	**$6.1**	***$51.9***	**$18.8**	**$2.5**
Gulf Coast	*14,085*	*51.1*	*693*			*$49.2*			*$13.6*	
East	*9,562*	*9.5*	*515*			*$53.8*			*$54.4*	
West	*2,286*	*4.4*	*28*			*$12.3*			*$6.5*	
Other and Eliminations	*749*		*-14*							

Notes:
Total O&M includes Other Cost of Ops which includes ARO exp., insurance, property and other taxes
NYLD capacity excludes Thermal (1,645 MW)
Gulf Cost, East and West capacity exclude GenOn
Assumes GenOn Total O&M costs are allocated 80/20 to Core Generation's East and West segments
Development expenses ($90 Mn in 2016) are not included

Source: Company Filings, UBSe

How does it look vs. peers now?

We benchmark below NRG Core Generation and GenOn against the IPP peers, CPN and DYN. Overall, we are increasingly cautious on the potential for expectations to meet material cost cutting on the Core Generation side as we believe the $8-9/MWh higher total cost vs. peers mostly stems from characteristics of the portfolio itself rather than inefficiencies. See our latest transcript on the subject as well with ex-GenOn CEO Ed Muller.

- Indeed, while NRG Core Generation O&M/kW is higher than its peers at ~$46/kW vs.

~$37/kW, we suspect this is explained by the fleet itself: DYN and particularly CPN have a greater concentration of CCGTs which are cheaper to operate, while NRG Core Generation's portfolio is mainly composed natural gas steam turbine, oil, and coal-fired power plants.

▪··· NRG Core Generation SG&A/kW is sensibly similar to peers at $6.1/kW vs. $5.9/kW average for CPN and DYN. We again highlight GenOn's seemingly inflated SG&A which stands at ~double that of NRG Core Generation and the IPP peers on a $/kW basis. We suspect some of the difference could be explained by different cost allocation between O&M and SG&A at GenOn vs. Core Generation given the similar total expense levels.

▪··· NRG's maintenance CapEx seemed skewed towards GenOn in 2016, with more than 2/3 of the work performed at the sub. We note GenOn's maintenance CapEx is expected to decrease ~in half to $109 Mn in 2017. Further, we highlight NRG's total maintenance CapEx (Core Generation plus GenOn) is substantially lower than its peers at ~$7/kW vs. low teens.

Figure 5: IPP Cost Benchmarking Across the Various Line Items

	Core Generation	*GenOn*	CPN	DYN	*Avg. CPN/DYN*	*Δ NRG*
Operations						
Operating Capacity (MW)	26,682	*16,423*	25,908	25,314	*25,611*	
Total Generation (TWh)	64.9	*26.0*	105.5	101.1	*103.3*	
Average Capacity Factor (%)	28%	*18%*	46%	46%	*46%*	
Total O&M						
O&M ($Mn)	1,222	*639*	977	940	*959*	
O&M / Capacity ($/kW)	$45.8	*$38.9*	$37.7	$37.1	*$37.4*	
O&M / Generation ($/MWh)	$18.8	*$24.6*	$9.3	$9.3	*$9.3*	
SG&A						
SG&A Expenses ($Mn)	164	*208*	140	161	*151*	
SG&A / Capacity ($/kW)	$6.1	*$12.7*	$5.4	$6.4	*$5.9*	
SG&A / Generation ($/MWh)	$2.5	*$8.0*	$1.3	$1.6	*$1.5*	
Maintenance CapEx						
SG&A Expenses ($Mn)	93	*205*	405	253	*329*	
SG&A / Capacity ($/kW)	$3.5	*$12.5*	$15.6	$10.0	*$12.8*	
SG&A / Generation ($/MWh)	$1.4	*$7.9*	$3.8	$2.5	*$3.2*	
Total Expenses						
Total Expenses ($Mn)	1,479	*1,052*	1,522	1,354	*1,438*	
Total Exp / Capacity ($/kW)	$55.4	*$64.1*	$58.7	$53.5	*$56.1*	
Total Exp / Generation ($/MWh)	$22.8	*$40.5*	$14.4	$13.4	*$13.9*	

Notes:
CPN data is for the whole company (including retail segment)
DYN data excludes Engie assets

Source: Company Filings, UBSe

Comparing Fleets

We include below a fleet comparison by fuel and ISO and again highlight NRG Core

Generation's greater concentration of gas ST and oil-fired power plants vs. peers. We highlight the DYN data excludes the Engie assets; once included, the proportion of CCGTs in the portfolio will increase by ~10 points at the expense of coal, while the exposure to ERCOT will rise from 0% to 15%, at the expense of CAISO and MISO.

Figure 6: Fleet Comparison

Fleet Comparison - By Fuel Type				
% of Operating Capacity	**Core Generation**	***GenOn***	**CPN**	**DYN**
Gas CCGT	12%	*13%*	85%	3
Gas CT	9%	*6%*	8%	1
Gas ST	26%	*41%*	3%	
Oil	14%	*15%*	1%	
Coal	33%	*25%*	0%	4
Nuclear	4%	*0%*	0%	
Other	0%	*0%*	3%	
Total	**100%**	***100%***	**100%**	**10**

Fleet Comparison - By ISO				
% of Operating Capacity	**Core Generation**	***GenOn***	**CPN**	**DYN**
PJM	20%	*59%*	19%	4
MISO	13%	*5%*	3%	2
ISO-NE	6%	*7%*	8%	1
NYISO	13%	*7%*	1%	
CAISO	9%	*23%*	22%	1
ERCOT	39%	*0%*	36%	
Other	0%	*0%*	10%	
Total	**100%**	***100%***	**100%**	**10**

Note: For cost comparison purposes, DYN data excludes the Engie assets

Source: Company Filings, SNL Financial

NRG Energy Inc. UBS Research

PIVOTAL QUESTIONS return Ó

Q: Is the GenOn settlement a good outcome for NRG?

UBS VIEW

We believe the $150 Mn net cash contribution ($261 Mn contribution plus ~$13 Mn pension contribution in 2017, partially offset by the return of $125 Mn on the revolver) and the assumption of ~$120 Mn of pension liability as part of the settlement with noteholders is a positive for NRG as that amount is lower than many investors feared given the tangible threats of substantial litigation, notably related to the Shared Services Agreement (see our related note here) and previous asset transfers. The main question remains the extent to which the company can cope with losing the Shared Services Agreement. While the company remains confident it can offset a significant portion of the loss, it remains unclear how much of these savings would be specific to GenOn or as part of the broader cost evaluation with the BRC (Business Review Committee). Finally, the entitlement to a "worthless stock deduction for federal income tax purposes" would result in NOLs (magnitude TBD), which could provide some upside.

EVIDENCE

The $150 Mn net cash contribution and ~$120 Mn of pension liability assumption is substantially lower than the $729 Mn litigation filed by the GenOn noteholders. In addition, separating from GenOn would avoid ~$300 Mn/year avg. negative FCF generation under the current structure according to our forecast. Finally, losing the GenOn portfolio would increase NRG's relative exposure to premium-priced ComEd to 84% of PJM capacity, while overall portfolio exposure to ERCOT (the power market on which we are the most constructive – see our ERCOT CDR note here) from 24% to 39%.

WHAT'S PRICED IN?

NRG's stock price increased by ~$0.50/Sh since the first GenOn settlement 8K was released on May 23. While the timeline coincides with the results of the PJM auction, making it challenging to isolate the true impact, we believe the market took the announcement positively. The key question remains how much dis-synergy offset does the street believe the company can achieve.

GenOn Projections

We include below our GenOn EBITDA projections. We highlight the degrading profitability profile in the later years, particularly in PJM given the sharp decline in capacity payments, notably in MAAC and PEPCO where the majority of GenOn's fleet is located.

Figure 7: GenOn EBITDA Projections

GenOn EBITDA by Segment ($Mn)	2016A	2017E	2018E	2019E	2020E
Eastern PJM	209	70	44	(3)	(55)
Western PJM/MISO	274	(23)	53	2	(30)
California	27	27	27	27	27
Other (New England, NY etc.)	39	69	103	61	36
Energy Marketing/Gas Contracts	2	2	2	2	2
Adj. EBITDA	**551**	**144**	**228**	**89**	**(20)**
Adjusted EBITDA Guidance		**145**			
Plus: Operating Lease Expense	112	112	112	112	112
Adj. EBITDAR	**663**	**256**	**340**	**201**	**92**
2016E Net Debt / Adj. EBITDA	**2.7x**	**10.3x**	**6.5x**	**16.8x**	**-74.3x**
2016E Net Debt Incl. Leases / Adj. EBITDAR	**3.8x**	**9.8x**	**7.4x**	**12.5x**	**27.4x**

Source: Company Filings, UBSe

We also include below our GenOn FCF projections and emphasize the current structure would result in ~$300 Mn negative FCF generation per year on average.

Figure 8: GenOn FCF Projections

GenOn Free Cash Flow Walk	2017E	2018E	2019E	2020E
Beginning Cash Balance	**1,034**	**738**	**602**	**326**
Adjusted EBITDA	**144**	**228**	**89**	**(20)**
Less: Interest Expense	(235)	(235)	(235)	(235)
Less: Other Adjustments	(126)	(50)	(50)	(50)
Less: Total Capex	(79)	(79)	(79)	(79)
Free Cash Flow	**(296)**	**(136)**	**(276)**	**(384)**
Ending Cash Balance	**738**	**602**	**326**	**(58)**
FCF Guidance	**(300)**			

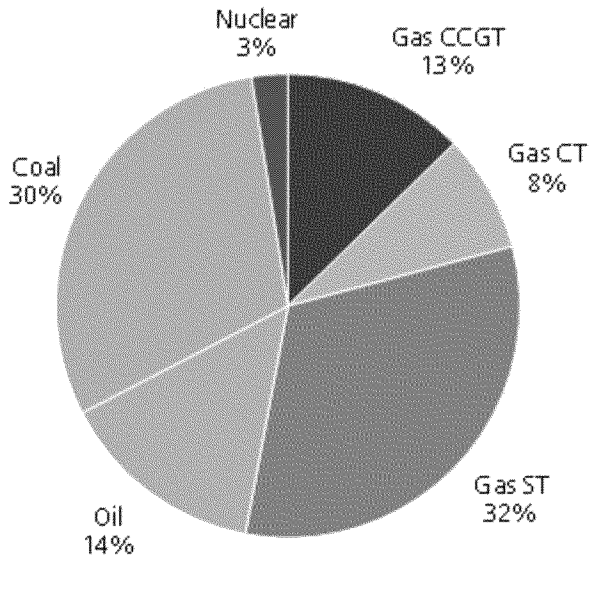
Source: Company Filings, UBSe

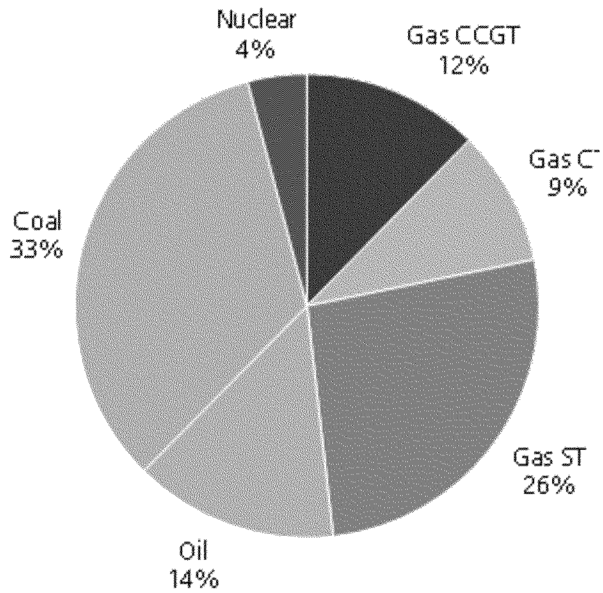
What does NRG look like without GenOn?

By fuel type: We note the portfolio composition by fuel wouldn't necessarily change much:

Figure 9: Total Capacity by Fuel – With GenOn scenario

Figure 10: Total Capacity by Fuel – Without GenOn scenario



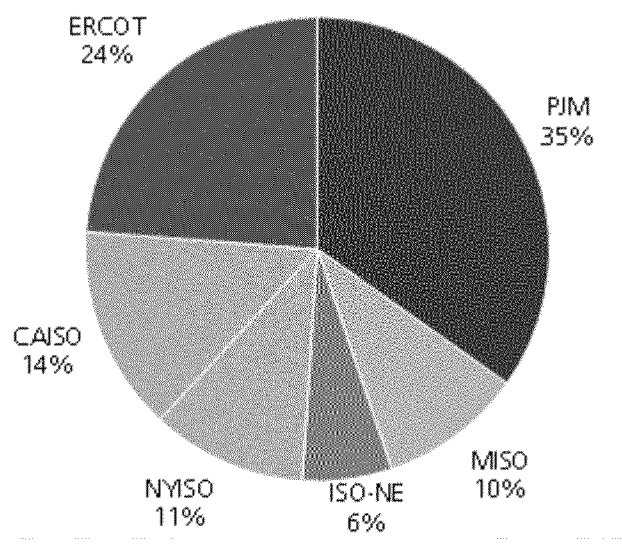


Source: Company Filings, SNL Financial, UBS

Source: Company Filings, SNL Financial, UBS

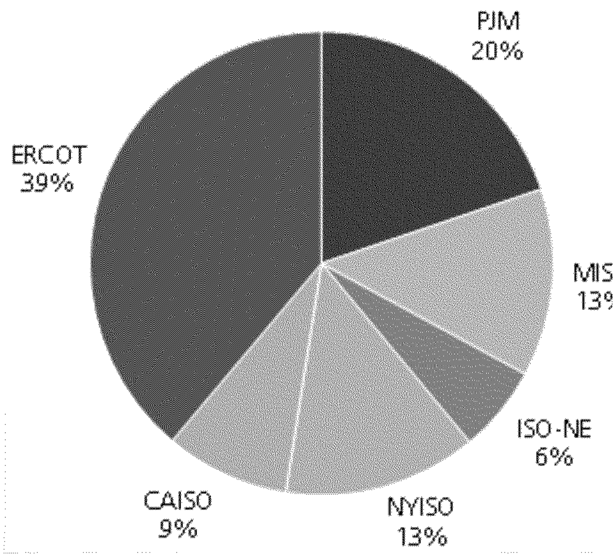
By ISO: Without GenOn, NRG's exposure to PJM would decrease significantly from ~35% to ~20%, while the portfolio would become more concentrated in ERCOT, with the TX market accounting for ~39% of capacity vs. ~24% currently.

Figure 11: Total Capacity by ISO – With GenOn scenario



Source: Company Filings, SNL Financial, UBS

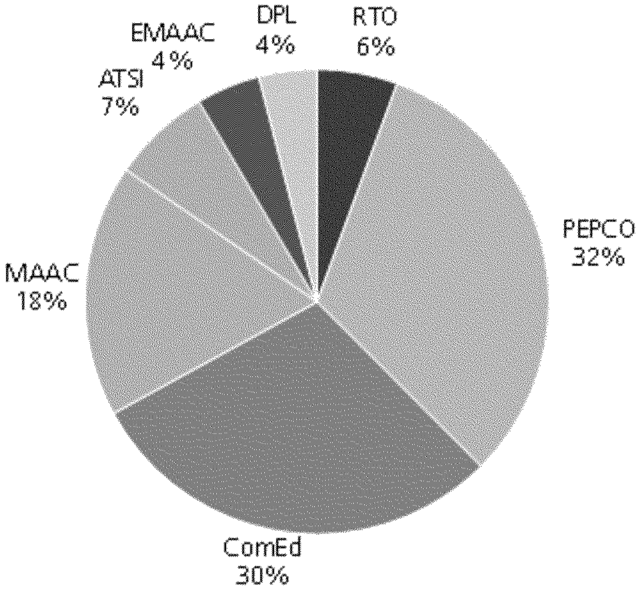
Figure 12: Total Capacity by ISO – Without GenOn scenario



Source: Company Filings, SNL Financial, UBS

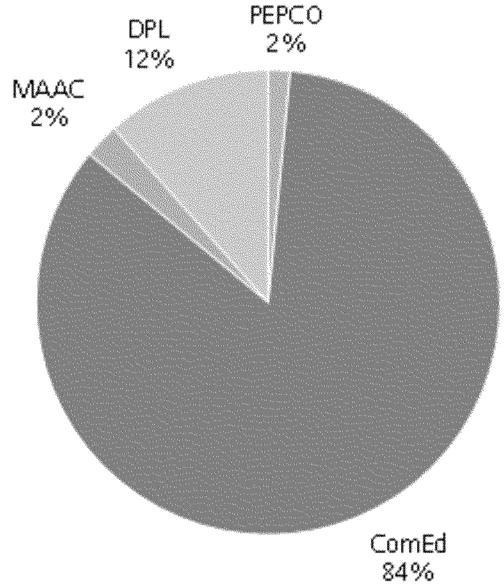
Within PJM: The remaining NRG (ex-GenOn) would then largely become a ComEd play with ~84% of total capacity in this zone vs. only ~30% currently.

Figure 13: PJM Capacity by Zone – With GenOn scenario



Source: Company Filings, SNL Financial, UBS

Figure 14: PJM Capacity by Zone – Without GenOn scenario



Source: Company Filings, SNL Financial, UBS

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Source: UBS. Rating allocations are as of 30 September, 2016
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